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TAX CONVENTION WITH THE UNITED KINGDOM (ON BEHALF OF BERMUDA)

MESSAGE

FROM

THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND (ON BEHALF OF THE GOVERNMENT OF BERMUDA) RELATING TO THE TAXATION OF INSURANCE ENTERPRISES AND MUTUAL ASSISTANCE IN TAX MATTERS, WITH A RELATED EXCHANGE OF NOTES, SIGNED AT WASHINGTON ON JULY 11, 1986

SEPTEMBER 10, 1986.—Convention was read the first time, and together with the accompanying papers, referred to the Committee on Foreign Relations and ordered to be printed for the use of the Senate.

U.S. GOVERNMENT PRINTING OFFICE

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LETTER OF TRANSMITTAL

THE WHITE HOUSE, *September 9, 1986.*

To the Senate of the United States:

I transmit herewith, for Senate advice and consent to ratification, the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland (on behalf of the Government of Bermuda) relating to the Taxation of Insurance Enterprises and Mutual Assistance in Tax Matters, together with a related exchange of notes, signed at Washington on July 11, 1986. I also transmit the report of the Department of State on the Convention.

The Convention is the first tax treaty applicable to Bermuda to be negotiated between the United States and the United Kingdom. It is not a comprehensive income tax treaty; rather it is limited to two issues: the taxation of insurance enterprises and mutual assistance in tax matters. Nevertheless, the Convention should have a beneficial impact on our overall relationship with Bermuda.

I recommend that the Senate give early and favorable consideration to the Convention, together with the related exchange of notes, and give its advice and consent to ratification.

RONALD REAGAN.

LETTER OF SUBMITTAL

DEPARTMENT OF STATE,
Washington, September 5, 1986.

The PRESIDENT,
The White House.

THE PRESIDENT: I have the honor to submit to you, with a view to its transmission to the Senate for advice and consent to ratification, the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland (on behalf of the Government of Bermuda) relating to the Taxation of Insurance Enterprises and Mutual Assistance in Tax Matters, with a related exchange of notes, signed at Washington on July 11, 1986.

The Convention is the first tax treaty applicable to Bermuda to be negotiated between the United States and the United Kingdom. It is limited to two issues: the taxation of insurance enterprises and mutual assistance in tax matters. The Convention grants to Bermudian insurance companies the same level of protection against United States income and excise taxes on their insurance premium income as is available to Barbadian insurance companies under the United States-Barbados income tax treaty. The Convention also requires that Bermuda provide the United States with information for purposes of enforcing United States tax laws.

Article 4 of the Convention provides for the exemption of Bermudian insurance enterprises from United States income and excise taxes on their U.S. premium income if they do not have a permanent establishment in the United States. In the absence of treaty protection, a Bermudian insurer would generally be subject to the United States excise tax on premiums it derived from insuring U.S. risks without engaging in a trade or business in the United States, and it would generally be subject to U.S. income tax on premiums it derived from insuring U.S. risks as part of its conduct of a trade or business in the United States.

To qualify for the treaty protection, the predominant business activity of the enterprise in question must be the issuing of insurance, reinsurance, or annuity contracts and the investing of insurance reserves and other capital incident to the carrying on of the insurance business (paragraph 1(d) of Article 1). The definition of "permanent establishment" contained in Article 3 of the Convention is similar to that of the United States-Barbados income tax convention, signed at Bridgetown, December 31, 1984, as it applies to insurance enterprises.

The Convention contains provisions designed to prevent third-country residents from taking unwarranted advantage of the treaty ("treaty-shopping") by routing income through an entity estab-

lished for that purpose in one of the Covered Jurisdictions. It provides that benefits granted under the Convention to an item of income by one of the Covered Jurisdictions will not be granted if (1) less than 50 percent of the beneficial interest in the person receiving the income is owned by residents of Bermuda or the United States, or by United States citizens, or (2) a substantial part of the income of the person receiving the income is used to meet liabilities to persons other than residents of a Covered Jurisdiction or United States citizens. However, these provisions shall not apply if the person deriving the income is a company which is a resident of a Covered Jurisdiction in whose principal class of shares there is substantial and regular trading on a recognized stock exchange.

Article 5 of the Convention provides for mutual assistance with regard to tax fraud (which is understood to include civil tax fraud), tax evasion (which is understood to cover all tax crimes) and other tax matters. The exchange of notes elaborates these obligations, making clear that they include exchange of information. Bermuda has in large part waived its bank secrecy rules for information relevant to tax years beginning after the Convention enters into force. Bermuda's obligations to waive existing rules of confidentiality are somewhat more limited, however, for information relevant to tax years beginning before the treaty enters into force. This means that, with respect to such earlier tax years, for criminal tax matters, attorney-client privilege will apply; for civil tax, attorney-client and banker-client privileges and statutory confidentiality protections will apply. The notes also confirm that Bermudian law does not permit the issuance of bearer shares. Based on these provisions, the notes further state that upon entry into force of the Convention, the United States will be prepared to certify Bermuda as a country eligible for establishment of Foreign Sales Corporations under section 927(e)(3) of the Internal Revenue Code, and to enter into an executive agreement which would incorporate by reference the provisions of Articles 5 and 6 of the Convention and the note, which would make Bermuda eligible for convention tax deduction treatment under section 274(h)(6) of the Code.

The exchange of notes also provides that Bermuda will pass legislation implementing the Convention which will ensure that information protected under prior law may be exchanged and that instruments of ratification will not be exchanged until such implementing legislation has been enacted. Bermuda enacted such legislation on August 29, 1986.

A technical memorandum explaining in detail the provisions of the Convention is being prepared by the Department of the Treasury and will be submitted separately to the Senate Committee on Foreign Relations.

Ratification of this Convention is also important for foreign policy and national security reasons. It resolves a vexing issue in our relations with respect to Bermuda, and will contribute to the continuation of cooperation in mutual defense matters.

The Department of the Treasury, with the cooperation of the Department of State, was primarily responsible for the negotiation of this Convention. It has the approval of both Departments.

Respectfully submitted,

JOHN C. WHITEHEAD.

Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland (on Behalf of the Government of Bermuda) Relating to the Taxation of Insurance Enterprises and Mutual Assistance in Tax Matters

The Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland (on behalf of the Government of Bermuda), desiring to conclude a convention with respect to the taxation of insurance enterprises and mutual assistance in tax matters, have agreed as follows:

ARTICLE 1

General Definitions

1. In this Convention, unless the context otherwise requires:

(a)(i) the term "United States" means the United States of America, but does not include Puerto Rico, the Virgin Islands, Guam, or any other United States possession or territory; and

(ii) the term "Bermuda" means the islands in the Atlantic Ocean known as Bermuda;

(b) the term "person" includes an individual, an estate, a trust, a company, a partnership, and any other body of persons;

(c) the term "company" means any body corporate or any entity which is treated as a body corporate for tax purposes;

(d) the term "enterprise of insurance" means an enterprise of which the predominant business activity during the taxable year is the issuing of insurance or annuity contracts or acting as the reinsurer of risks underwritten by insurance companies, together with the investing or reinvesting of assets held in respect of insurance reserves, capital, and surplus incident to the carrying on of the insurance business;

(e) the terms "enterprise of a Covered Jurisdiction" and "enterprise of the other Covered Jurisdiction" mean respectively an enterprise carried on by a resident of a Covered Jurisdiction and an enterprise carried on by a resident of the other Covered Jurisdiction;

(f) the term "competent authority" means:

(i) in the case of the United States, the Secretary of the Treasury or his delegate; and

(ii) in the case of Bermuda, the Minister of Finance or his delegate;

(g) the term "insurance obligation" means any obligation which, in accordance with normal industry practice, an insurer undertakes under the terms of a contract of insurance, to

make payments or incur expenses in connection with the insurance protection offered under the contract, including any such obligation to pay claims to or for the benefit of the insured, resulting from damages connected with the covered risk, to pay interest on such claims, and to pay the costs of defending an insured against such damages, but in no event including any obligation to pay premiums or other costs of reinsuring the covered risk; and

(h) the term "Covered Jurisdiction" means the United States or Bermuda, as the context requires.

2. As regards the application of the Convention by a Covered Jurisdiction, any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a common meaning, have the meaning which it has under the laws of that Jurisdiction. For purposes of the United States, the preceding sentence shall refer to laws concerning taxes. The competent authorities may agree to a common meaning of a term for purposes of this Convention.

ARTICLE 2

Residence

For purposes of this Convention, the term "resident" of a Covered Jurisdiction means:

(a) in the case of the United States:

(i) any person, other than a company, resident in the United States for the purpose of United States tax; but in the case of a partnership, estate or trust, only to the extent that the imcome derived by such partnership, estate or trust is subject to United States tax as the income of a resident, either in its hands or in the hands of its partners or beneficiaries; and

(ii) a company created under the laws of the United States or a political subdivision thereof; and

(b) in the case of Bermuda:

(i) an individual who has the status of a legal resident of Bermuda; and

(ii) a company, partnership, trust, or association created under the laws of Bermuda.

ARTICLE 3

Permanent Establishment

1. For the purposes of Article 4, except as otherwise specified in this Article, the term "permanent establishment" means a regular place of business through which the business of an enterprise of insurance is wholly or partly carried on.

2. The term "permanent establishment" shall include especially a place of management, a branch, an office, and premises used as a sales outlet.

3. The term "permanent establishment" shall also include the furnishing of services, including consultancy, management, technical and supervisory services, within a Covered Jurisdiction by an

enterprise of insurance through employees or other persons but only if:

(a) activities of that nature continue within the Jurisdiction for a period or periods aggregating more than 90 days in a twelve-month period, provided that a permanent establishment shall not exist in any taxable year in which such services are rendered in that Jurisdiction for a period or periods aggregating less than 30 days in the taxable year; or

(b) the services are performed within the Jurisdiction for an associated enterprise.

For purposes of this paragraph, two enterprises shall be "associated" if either participates directly or indirectly in the management, control, or capital of the other, or if the same persons participate directly or indirectly in the management, control, or capital of both.

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include any one or more of the following:

(a) the maintenance of a regular place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise of insurance; or

(b) the maintenance of a regular place of business solely for the purpose of advertising, for the supply of information, for scientific research or for similar activities which have a preparatory or auxiliary character, for the enterprise.

5. Notwithstanding the provisions of paragraphs 1, 2, and 3, a person (other than an agent of independent status to whom paragraph 6 applies) acting in a Covered Jurisdiction on behalf of an enterprise of insurance of the other Covered Jurisdiction shall be deemed to be a permanent establishment of that enterprise in the first-mentioned Jurisdiction if he has and habitually exercises in the first-mentioned Jurisdiction an authority to conclude contracts on behalf of the enterprise, unless his activities are limited to those mentioned in paragraph 4 which, if exercised through a regular place of business, would not make that regular place of business a permanent establishment under the provisions of that paragraph.

6. An enterprise of insurance shall not be deemed to have a permanent establishment in a Covered Jurisdiction merely because it carries on business in that Jurisdiction through a broker, general commission agent, or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business. However, when the activities of such person are devoted substantially on behalf of that enterprise, he shall not be considered an agent of independent status within the meaning of this paragraph if the transactions between the agent and the enterprise were not made under arm's length conditions.

7. The fact that a company which is a resident of a Covered Jurisdiction controls or is controlled by a company which is a resident of the other Covered Jurisdiction, or which carries on business in that other Jurisdiction (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

ARTICLE 4

Taxation of Insurance Enterprises

1. The business profits of an enterprise of insurance of a Covered Jurisdiction derived from carrying on the business of insurance (including insubstantial amounts of income incidental to such business) shall not be taxable in the other Covered Jurisdiction unless the enterprise carries on or has carried on business in the other Jurisdiction through a permanent establishment situated therein. If the enterprise carries on or has carried on business as aforesaid, the business profits of the enterprise may be taxed in the other Jurisdiction but only so much of them as is attributable to that permanent establishment. Nothing in this Convention shall prevent the United States from taxing its residents (as determined under Article 2(a)) and its citizens as if this Convention had not entered into force.

2. Where an enterprise of insurance of one of the Covered Jurisdictions carries on or has carried on business through a permanent establishment in the other Jurisdiction, there shall in each Covered Jurisdiction be attributed to the permanent establishment business profits which would reasonably be expected to have been derived by it, if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions. In determining the business profits of a permanent establishment in a Covered Jurisdiction through which an enterprise of insurance of the other Jurisdiction carries on or has carried on business, there shall be allowed as deductions, for purpose of tax imposed by the first-mentioned Jurisdiction other than excise taxes on premiums paid to foreign insurers, expenses which are incurred for the purposes of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expense, interest, and other expenses incurred for the enterprise of insurance as a whole (or the part thereof which includes the permanent establishment), whether incurred in the Jurisdiction in which the permanent establishment is situated or elsewhere. For the purposes of this paragraph, the business profits to be attributed to a permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary. Nothing in this Article shall affect taxation by a Covered Jurisdiction of dividends, interest, royalties, gains or compensation for services beneficially owned by a resident of the other Covered Jurisdiction if such items of income are not attributable to a permanent establishment of the beneficial owner of such income in the first-mentioned Jurisdiction.

3. A person which is a resident of a Covered Jurisdiction and which derives income from sources within the other Covered Jurisdiction shall not be entitled, in the other Covered Jurisdiction, to relief from taxation under this Article if:

(a) 50 percent or less of the beneficial ownership of such person is owned, directly or indirectly, by any combination of one or more individual residents of a Covered Jurisdiction or citizens of the United States; or

(b) the income of such person is used in substantial part, directly or indirectly, to make distributions (where such distributions are made with respect to beneficial ownership interests and are substantially disproportionate to such interests) to, or to meet liabilities (including liabilities for interest, royalties, or other expenses, but not including liabilities, whether or not for interest or other expenses, which constitute insurance obligations) to, persons who are neither residents of either of the Covered Jurisdictions nor citizens of the United States.

If one of the Covered Jurisdictions proposes to deny benefits to a resident of the other Covered Jurisdiction by reason of this paragraph, the competent authorities of the Covered Jurisdictions shall, upon request of the competent authority of the other Covered Jurisdiction, consult each other.

4. The provisions of paragraph 3 shall not apply if the person deriving the income is a company which is a resident of a Covered Jurisdiction in whose principal class of shares there is substantial and regular trading on a recognized stock exchange. For purposes of the preceding sentence, the term "recognized stock exchange" means:

(a) the NASDAQ System owned by the National Association of Securities Dealers, Inc. and any other stock exchange registered with the Securities and Exchange Commission as a national securities exchange for purposes of the Securities Exchange Act of 1934; and

(b) any other stock exchange agreed upon by the competent authorities of the Covered Jurisdictions.

5. Nothing in this Convention shall limit any provisions of the law of either Covered Jurisdiction which permit the distribution, apportionment, or allocation of income, deductions, credits, or allowances between persons, whether or not residents of a Covered Jurisdiction, owned or controlled directly or indirectly by the same interests when necessary in order to prevent evasion of taxes or clearly to reflect the income of any of such persons.

6. The existing taxes to which this Article shall apply in the United States are the Federal income taxes imposed by the Internal Revenue Code (but excluding the accumulated earnings tax and the personal holding company tax), and the excise taxes imposed on insurance premiums paid to foreign insurers. This Article shall, however, apply to the excise taxes imposed on insurance premiums paid to foreign insurers only to the extent that the risks covered by such premiums are not reinsured with a persons not entitled to the benefits of this or any other convention which applies to these taxes. This Article shall also apply to any identical or substantially similar taxes which are imposed by the United States after the date of signature of the Convention in addition to, or in place of, the existing taxes, and shall also apply to any tax imposed by Bermuda after the date of signature of the Convention which is identical or substantially similar to the existing United States taxes to which this Article applies to the same extent as it applies to those existing taxes. The competent authorities of the Covered Jurisdictions shall notify each other of any significant changes which have been made in their respective taxation laws and of any official pub-

lished material concerning the application of the Convention, including explanations, regulations, rulings, or judicial decisions.

7. The taxation on a permanent establishment which an enterprise of insurance of a Covered Jurisdiction has in the other Covered Jurisdiction shall not be less favorably levied in that other Jurisdiction than the taxation levied on enterprises of insurance of that other Jurisdiction carrying on the same activities. This provision shall not be construed as obliging a Covered Jurisdiction to grant to residents of the other Covered Jurisdiction any personal allowances, reliefs, and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents. The provisions of this paragraph shall not be construed to prevent the United States from imposing an additional tax on the income of a permanent establishment maintained by a resident of Bermuda in the United States. Except where the provisions of paragraph 5 apply, interest, royalties, and other disbursements paid by a resident of a Covered Jurisdiction to an enterprise of insurance of the other Covered Jurisdiction shall, for purposes of determining the taxable profits of such resident, be deductible under the same conditions as if they had been paid to an enterprise of insurance of the first-mentioned Jurisdiction. For purposes of this paragraph, the term "taxation" means taxes which are the subject of this Convention.

ARTICLE 5

Mutual Assistance in Tax Matters

The competent authorities of the Covered Jurisdictions shall provide assistance as appropriate in carrying out the laws of the respective Covered Jurisdictions relating to the prevention of tax fraud and the evasion of taxes. In addition, the competent authorities shall, through consultations, develop appropriate conditions, methods, and techniques for providing, and shall thereafter provide, assistance as appropriate in carrying out the fiscal laws of the respective Covered Jurisdictions other than those relating to tax fraud and the evasion of taxes.

ARTICLE 6

Confidentiality

Any matters subject to assistance under Article 5 shall be treated as confidential in the same manner as such matters or items would be under the domestic laws of the Covered Jurisdiction requesting the assistance and, in any event, shall be disclosed only:

(a) in the case of the United States, to persons or authorities (including courts and administrative bodies) involved in the assessment, collection, or administration of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, taxes, and

(b) in the case of Bermuda, to the competent authority of Bermuda.

Such person or authorities shall use such matters or items only for purposes of the assessment, collection, or administration of, the en-

forcement or prosecution in respect of, or the determination of appeals in relation to, taxes. Such matters or items may be disclosed in public court proceedings or public decisions, but shall not be disclosed to any country other than one of the Covered Jurisdictions for any purpose.

ARTICLE 7

Entry into Force and Termination

1. This Convention shall be subject to ratification in accordance with the applicable procedures of each party and instruments of ratification shall be exchanged as soon as possible.

2. The Convention shall enter into force upon the exchange of instruments of ratification and its provisions shall have effect:

(a) in respect of excise taxes on insurance premiums paid to foreign insurers, for premiums paid or credited on or after January 1, 1986;

(b) in respect of income taxes imposed on the business profits derived by an enterprise of insurance, for such profits derived in taxable years beginning on or after the first day of the calendar year in which this Convention enters into force;

(c) in respect of mutual assistance covered by the first sentence of Article 5, for taxable years not barred by the statute of limitations of the Covered Jurisdiction requesting such assistance; provided, however, that neither Covered Jurisdiction shall be required by Article 5 to provide such assistance with respect to taxable years beginning prior to January 1, 1977; and

(d) in respect of mutual assistance covered by the second sentence (and not also described in the first sentence) of Article 5, for taxable years not barred by the statute of limitations of the Covered Jurisdiction requesting such assistance; provided, however, that neither Covered Jurisdiction shall be required by Article 5 to provide such assistance with respect to:

(i) taxable years beginning prior to January 1, 1977; or

(ii) taxable years beginning prior to the entry into force of the Convention if the provisions of such assistance would cause or result in the breach of an obligation to maintain confidentiality of information under the laws of such Jurisdiction in effect on the date of signature of the Convention.

2. The Convention shall continue in force indefinitely, but either party may give notice of termination to the other party on or after June 30 of the year following the calendar year in which this Convention enters into force and in such event the Convention shall terminate on the first day of the seventh full calendar month following that in which the notice is given.

Done at Washington, in duplicate, this Eleventh day of July, 1986.

For the Government of the United States of America:

JOHN C. WHITEHEAD.

For the Government of the United Kingdom of Great Britain and Northern Ireland (on behalf of the Government of Bermuda):

JOHN SWAN.

The Department of State refers the British Embassy to the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland (on behalf of the Government of Bermuda) relating to the taxation of Insurance Enterprises and Mutual Assistance in Tax Matters (the "Convention"), signed today. In the course of discussions involving the Convention, the following understandings were reached between representatives of the United States and Bermuda (each referred to herein as a "Covered Jurisdiction"):

(1) The United States Government noted that in order to implement the relief from excise taxes pursuant to paragraph 1 of Article 4 of the Convention it would be necessary to establish procedures which would, *inter alia,* ensure that companies claiming the benefits of that paragraph are entitled to such benefits and, in the case of refunds, that the amount and recipient of such refunds are properly determined. Representatives of Bermuda assured the representatives of the United States Government of Bermuda's willingness to establish such procedures as may be mutually agreed to ensure that relief from the excise tax is obtained by appropriate persons.

(2) The United States Government noted that paragraph 3 of Article 4 of the Convention limits the availability of the exemption granted to insurance enterprises by either Covered Jurisdiction under the Convention to persons resident in the other Covered Jurisdiction which (i) are more than 50 percent owned, directly or indirectly, by individual residents of the Covered Jurisdictions or U.S. citizens; and (ii) do not use their income in substantial part, directly or indirectly, to make certain payments to persons who are neither residents of a Covered Jurisdiction nor U.S. citizens. The United States Government indicated that, for purposes of the ownership test in that provision, it would not treat any individual as owning "indirectly" through an intermediary entity and beneficial interest in an entity resident in one of the Covered Jurisdictions if the evidence of and rights to the ownership of any interest in such intermediary entity are in bearer form. For purposes of the second test, the term "liabilities" refers to payments which reduce gross premiums or are deductible against gross income, and includes interest, royalties, and premiums paid in connection with reinsuring risks. Also, if the sum of (i) the ratio with reinsurance premium payments bears to gross premiums less return premiums and (ii) the ratio which payments of other liabilities bear to (a) gross premiums less return premiums and less reinsurance premium payments plus (b) gross income from all other activities, is not more than 50 percent, such payments will not generally be considered "substantial," provided that in appropriate circumstances a lower aggregate percentage will be considered "substantial."

(3) The United States Government expressed its concern that the obligations of a Covered Jurisdiction not be construed to establish an obligation to provide assistance with respect to matters other than those relating to the domestic laws of a Covered Jurisdiction respecting taxes. The representatives of the United States and Ber-

muda agreed that the intended scope of Article 5 of the Convention is limited to assistance relating to the domestic laws of the Covered Jurisdictions concerning taxes.

(4) Representatives of Bermuda expressed concerns as to the policies of the United States Government regarding assistance that might relate to persons not resident in one of the two Covered Jurisdictions and matters that do not constitute a criminal investigation. The representatives of the United States Government discussed with the representatives of Bermuda the United States' policies relating to information exchange. The representatives of the United States and Bermuda agreed that, where the United States requests assistance with respect to a matter which (i) relates to a person not resident in one of the two Covered Jurisdictions or (ii) does not constitute a United States criminal or tax fraud investigation, a senior official designated by the Secretary of the Treasury shall certify such request as being relevant to and necessary for the determination of the tax liability of a United States taxpayer, or the criminal tax liability of a person under the laws of the United States. The representatives of the United States and Bermuda further agreed that, in connection with any assistance relating to persons not resident in one of the two Covered Jurisdictions, it shall be established to the satisfaction of the competent authority of the requested Jurisdiction that such assistance is necessary for the proper administration and enforcement of the fiscal laws of the requesting jurisdiction. Where such necessity has been duly established, the competent authorities shall consult as to the appropriate form of such assistance.

(5) The representatives of the United States and Bermuda agreed that, subject to the limitations described in and agreement to procedures referred to in paragraph (4) above, it is intended that the mutual assistance to be provided under Article 5 of the Convention come into effect under the limitations of Article 7 as follows:

(i) Subject to paragraph (iv), Bermuda's obligation under the Convention to provide assistance with respect to civil and criminal tax matters relating to taxable years of a taxpayer beginning after the entry into force of the Convention will not be limited by any confidentiality restrictions of Bermudian law, other than those relating to solicitor-client privilege.

(ii) With respect to matters relating to taxable years of a taxpayer beginning before the entry into force of the Convention (but beginning on or after January 1, 1977 and not barred by the statute of limitations), paragraph 2(d) (ii) of Article 7 limits Bermuda's obligation to provide assistance with respect to civil tax matters (other than civil fraud) if the provision of such assistance would entail breach of an obligation to maintain confidentiality of information under the laws of Bermuda in effect on the date of signature of the Convention. Under this standard, confidential information would only include information protected by Bermudian statutory and common law. It is understood that under Bermudian common law confidential information would include information protected by the common law solicitor-client privilege and banker-client privilege. It was agreed that if a taxpayer claims that other categories of information are protected under Bermudian common law, and if the

United States so requests, the Government of Bermuda will have such a claim determined in the courts of Bermuda.

(iii) Bermuda's obligation under subparagraph 2(c) of Article 7 to provide assistance with respect to criminal tax matters (and tax matters involving civil fraud) relating to taxable years of a taxpayer beginning before the entry into force of the Convention (but on or after January 1, 1977 and not barred by the statute of limitations) would only be limited by the confidentiality obligations of the solicitor-client privilege.

(iv) Bermuda's obligation under the Convention to provide assistance with respect to civil tax matters (other than civil fraud) relating to a taxpayer's taxable years beginning after the entry into force of the Convention will not require it to cause any person to breach a legal obligation to maintain confidentiality of documents or information, properly asserted by such person under the laws of Bermuda as in effect on the date of signature of the Convention, where such documents or information were created in or derived from periods prior to the date of entry into force of the Convention. However, the limitation on Bermuda's obligation described in the preceding sentence will not apply to documents or information created in or derived from a date preceding the entry into force of the Convention that are relevant to a request relating to taxable years after the entry into force of the Convention and are of a kind that have a continuing operational effect. For example, if assistance is requested with respect to a taxpayer's bank transactions occurring after the entry into force of the Convention and the signature card for the account in question was executed prior to the entry into force of the convention, Bermuda's obligation to provide assistance with respect to such a signature card would not be affected by confidentiality restrictions. Similarly, if a taxpayer's depreciation deduction for a year after entry into force of the Convention is under examination, Bermuda's obligation to provide assistance with respect to information about the purchase price of the property in question, if such property was acquired before the entry into force of the Convention, would not be affected by any confidentiality restrictions of Bermudian law.

(6) The representatives of the United States Government expressed concerns regarding whether assistance would be provided in a form which would permit its use in judicial or administrative proceedings. The representatives of the United States and Bermuda agreed that under Article 5 of the Convention, it was intended that, if specifically requested by a competent authority of a Covered Jurisdiction, the competent authority of the other Covered Jurisdiction shall provide information in the form of depositions of witnesses and authenticated copies of original documents (including books, papers, statements, records, accounts and writings) to the same extent such depositions and documents can be obtained under the laws and administrative practices of that other Jurisdiction.

(7) Representatives of Bermuda also expressed concerns as to the scope for use of unilateral compulsory measures by one Covered Jurisdiction to obtain documents, records, or other materials located

in the territory of the other Covered Jurisdiction, and within the scope of assistance under the Convention, after entry into force of the Convention. In this context the representatives of the United States Government confirmed that, with respect to documents, records, or other materials in the custody of a resident of a Covered Jurisdiction and located in the territory of that Jurisdiction, it shall be the policy of the United States, where practicable, to request assistance pursuant to the provisions of the Convention before using unilateral measures.

(8) The representatives of the United States Government inquired whether shares of a company organized under the laws of Bermuda could be issued in bearer form. The representatives of Bermuda informed the United States representatives that the laws of Bermuda did not permit the issuance of company shares to an unnamed person.

(9) The United States representatives sought clarification that matters that were the subject of assistance under the Convention but that are made public in accordance with Article 6 of the Convention would not be further subject to Article 6. The representatives of the United States and Bermuda agreed that matters that are the subject of assistance under the Convention but that are made public in accordance with the Convention would not be further subject to Article 6.

(10) The representatives of the Government of the United States observed that, under the legal system applicable in Bermuda, the Convention is not self-executing and that legislation would be required in order to implement the provisions of the Convention. The representatives of Bermuda understood that instruments of ratification would not be exchanged until such legislation as may be required to implement the provisions of the Convention has been enacted. It was further understood that the Convention would be ratified and other necessary steps, such as the adoption of implementing legislation necessary to meet the obligations of the Convention, would be taken so as to permit the exchange of instruments of ratification at the earliest possible date.

(11) The representatives of Bermuda inquired whether, following the entry into force of the Convention, the Secretary of the Treasury of the United States would be prepared to certify that assistance under the Convention, and subject to the understandings of this Note, would be satisfactory for purposes of section 927(e)(3) of the Internal Revenue Code of 1954, as amended (the "Code"), relating to countries qualifying as a jurisdiction in which a Foreign Sales Corporation (FSC) may be organized. The representatives of Bermuda also inquired whether the assistance provided for in the Convention, subject to the understandings of this Note, would be satisfactory for purposes of eligibility for convention tax benefits under section 274(h)(6) of the Code.

The representatives of the United States stated that upon entry into force of the Convention, and subject to the understandings contained in this Note, the Secretary of the Treasury, or his delegate, will be prepared to certify Bermuda for purposes of section 927(e)(3) of the Code such that a company organized under the laws of Bermuda may qualify as a FSC. Such certification would be published in the Federal Register and may be terminated effective six

months after the date of publication of a notice of termination in the Federal Register. The United States Government also stated that, upon entry into force of the Convention, the Secretary of the Treasury, or his delegate, will be prepared to execute on behalf of the United States Government an executive agreement satisfying the requirements of section 274(h)(6) of the Code, which would incorporate by cross-reference the provisions of Articles 5 and 6 of the Convention and this Note, and would allow persons incurring expenses for attending business conventions in Bermuda to claim deductions for such expenses as though Bermuda were included as part of the "North American area."

(12) The representatives of Bermuda emphasized the necessity of including in the Convention additional provisions intended to prevent changes in U.S. income tax treaty policy from adversely affecting the economic position of Bermuda's insurance and tourism industries relative to those of U.S. treaty partners in similar circumstances under current U.S. tax treaty policy. The United States representatives were not able to accept such provisions. However, the United States Government recognizes that insurance and tourism currently play a vital role in the Bermudian economy. If, in the future, the income tax treaty policies of the United States change in a manner which would have a material, adverse effect on such Bermudian business activities, compared with existing circumstances, the United States Government would be prepared to reopen the discussions in order to take account of such change in policies.

The Department of State confirms that the foregoing understandings are in accord with the view of the Government of the United States and are approved by it. The Department of State would appreciate confirmation that such understandings are acceptable to the Government of the United Kingdom on behalf of Bermuda.

DEPARTMENT OF STATE,
Washington, July 11, 1986.

NOTE No: 108

Her Britannic Majesty's Embassy present their compliments to the Department of State and have the honour to refer to the Department's Note of 11 July regarding the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland (on behalf of the Government of Bermuda) relating to the Taxation of Insurance Enterprises and Mutual Assistance in Tax Matters (the "Convention"), signed today. The Department's Note states that in the course of discussions involving the Convention, the following understandings were reached between representatives of the United States and Bermuda (each referred to herein as a "Covered Jurisdiction"):

(1) The United States Government noted that in order to implement the relief from excise taxes pursuant to paragraph 1 of Article 4 of the Convention it would be necessary to establish procedures which would, inter alia, ensure that companies claiming the benefits of that paragraph are entitled to such benefits and, in the case of refunds, that the amount and recipient of such refunds are

properly determined. Representatives of Bermuda assured the representatives of the United States Government of Bermuda's willingness to establish such procedures as may be mutually agreed to ensure that relief from the excise tax is obtained by appropriate persons.

(2) The United States Government noted that paragraph 3 of Article 4 of the Convention limits the availability of the exemption granted to insurance enterprises by either Covered Jurisdiction under the Convention to persons resident in the other Covered Jurisdiction which (i) are more than 50 percent owned, directly or indirectly, by individual residents of the Covered Jurisdictions or US citizens; and (ii) do not use their income in substantial part, directly or indirectly, to make certain payments to persons who are neither residents of a Covered Jurisdiction nor US citizens. The United States Government indicated that, for purposes of the ownership test in that provision, it would not treat any individual as owning "indirectly" through an intermediary entity any beneficial interest in an entity resident in one of the Covered Jurisdictions if the evidence of and rights to the ownership of any interest in such intermediary entity are in bearer form. For purposes of the second test, the term "liabilities" refers to payments which reduce gross premiums or are deductible against gross income, and includes interest, royalties, and premiums paid in connection with reinsuring risks. Also, if the sum of (i) the ratio which reinsurance premium payments bears to gross premiums less return premiums and (ii) the ratio which payments of other liabilities bears to (a) gross premiums less return premiums and less reinsurance premium payments plus (b) gross income from all other activities, is no more than 50 percent, such payments will not generally be considered "substantial," provided that in appropriate circumstances a lower aggregate percentage will be considered "substantial."

(3) The United States Government expressed its concern that the obligations of a Covered Jurisdiction not be construed to establish an obligation to provide assistance with respect to matters other than those relating to the domestic laws of a Covered Jurisdiction respecting taxes. The representatives of the United States and Bermuda agreed that the intended scope of Article 5 of the Convention is limited to assistance relating to the domestic laws of the Covered Jurisdictions concerning taxes.

(4) Representatives of Bermuda expressed concerns as to the policies of the United States Government regarding assistance that might relate to persons not resident in one of the two Covered Jurisdictions and matters that do not constitute a criminal investigation. The representatives of the United States Government discussed with the representatives of Bermuda the United States' policies relating to information exchange. The representatives of the United States and Bermuda agreed that, where the United States requests assistance with respect to a matter which (i) relates to a person not resident in one of the two Covered Jurisdictions or (ii) does not constitute a United States criminal or tax fraud investigation, a senior official designated by the Secretary of the Treasury shall certify such request as being relevant to and necessary for the determination of the tax liability of a United States taxpayer, or the criminal tax liability of a person under the laws of the

United States. The representatives of the United States and Bermuda further agreed that, in connection with any assistance relating to persons not resident in one of the two Covered Jurisdictions, it shall be established to the satisfaction of the competent authority of the requested Jurisdiction that such assistance is necessary for the proper administration and enforcement of the fiscal laws of the requesting Jurisdiction. Where such necessity has been duly established, the competent authorities shall consult as to the appropriate form of such assistance.

(5) The representatives of the United States and Bermuda agreed that, subject to the limitations described in and agreement to procedures referred to in paragraph (4) above, it is intended that the mutual assistance to be provided under Article 5 of the Convention come into effect under the limitations of Article 7 as follows:

(i) Subject to paragraph (iv), Bermuda's obligation under the convention to provide assistance with respect to civil and criminal tax matters relating to taxable years of a taxpayer beginning after the entry into force of the Convention will not be limited by any confidentiality restrictions of Bermudian law, other than those relating to solicitor-client privilege.

(ii) With respect to matters relating to taxable years of a taxpayer beginning before the entry into force of the Convention (but beginning on or after January 1, 1977 and not barred by the statute of limitations), paragraph 2(d)(ii) of Article 7 limits Bermuda's obligation to provide assistance with respect to civil tax matters (other than civil fraud) if the provision of such assistance would entail breach of an obligation to maintain confidentiality of information under the laws of Bermuda in effect on the date of signature of the Convention. Under this standard, confidential information would only include information protected by Bermudian statutory and common law. It is understood that under Bermudian common law confidential information would include information protected by the common law solicitor-client privilege and banker-client privilege. It was agreed that if a taxpayer claims that other categories of information are protected under Bermudian common law, and if the United States so requests, the Government of Bermuda will have such a claim determined in the courts of Bermuda.

(iii) Bermuda's obligation under subparagraph 2(c) of Article 7 to provide assistance with respect to criminal tax matters (and tax matters involving civil fraud) relating to taxable years of a taxpayer beginning before the entry into force of the Convention (but on or after January 1, 1977 and not barred by the statute of limitations) would only be limited by the confidentiality obligations of the solicitor-client privilege.

(iv) Bermuda's obligation under the Convention to provide assistance with respect to civil tax matters (other than civil fraud) relating to a taxpayer's taxable years beginning after the entry into force of the Convention will not require it to cause any person to breach a legal obligation to maintain confidentiality of documents or information, properly asserted by such person under the laws of Bermuda as in effect on the date of signature of the Convention, where such documents or information were created in or derived from periods prior to the

date of entry into force of the Convention. However, the limitation on Bermuda's obligation described in the preceding sentence will not apply to documents or information created in or derived from a date preceding the entry into force of the Convention that are relevant to a request relating to taxable years after the entry into force of the Convention and are of a kind that have a continuing operational effect. For example, if assistance is requested with respect to a taxpayer's bank transactions occurring after the entry into force of the Convention and the signature card for the account in question was executed prior to the entry into force of the Convention, Bermuda's obligation to provide assistance with respect to such a signature card would not be affected by confidentiality restrictions. Similarly, if a taxpayer's depreciation deduction for a year after entry into force of the Convention is under examination, Bermuda's obligation to provide assisance with respect to information about the purchase price of the property in question, if such property was acquired before the entry into force of the Convention, would not be affected by any confidentiality restrictions of Bermudian law.

(6) The representatives of the United States Government expressed concerns regarding whether assistance would be provided in a form which would permit its use in judicial or administrative proceedings. The representatives of the United States and Bermuda agreed that under Article 5 of the Convention, it was intended that, if specifically requested by a competent authority of a Covered Jurisdiction, the competent authority of the Covered Jurisdiction shall provide information in the form of depositions of witnesses and authenticated copies of original documents (including books, papers, statements, records, accounts and writings) to the same extent such depositions and documents can be obtained under the laws and administrative practices of that other Jurisdiction.

(7) Representatives of Bermuda also expressed concerns as to the scope for use of unilateral compulsory measures by one Covered Jurisdiction to obtain documents, records, or other materials located in the territory of the other Covered Jurisdiction, and within the scope of assistance under the Convention, after entry into force of the Convention. In this context the representatives of the United States Government confirmed that, with respect to documents, records, or other materials in the custody of a resident of a Covered Jurisdiction and located in the territory of that Jurisdiction, it shall be the policy of the United States, where practicable, to request assistance pursuant to the provisions of the Convention before using unilateral measures.

(8) The representatives of the United States Government inquired whether shares of a company organized under the laws of Bermuda could be issued in bearer form. The representatives of Bermuda informed the United States representatives that the laws of Bermuda did not permit the issuance of company shares to an unnamed person.

(9) The United States representatives sought clarification that matters that were the subject of assistance under the Convention but that are made public in accordance with Article 6 of the Convention would not be further subject of Article 6. The representa-

tives of the United States and Bermuda agreed that matters that are the subject of assistance under the Convention but that are made public in accordance with the Convention would not be further subject to Article 6.

(10) The representatives of the Government of the United States observed that, under the legal system applicable in Bermuda, the Convention is not self-executing and that legislation would be required in order to implement the provisions of the Convention. The representatives of Bermuda understood that instruments of ratification would not be exchanged until such legislation as may be required to implement the provisions of the Convention has been enacted. It was further understood that the Convention would be ratified and other necessary steps, such as the adoption of implementing legislation necessary to meet the obligations of the Convention, would be taken so as to permit the exchange of instruments of ratification at the earliest possible date.

(11) The representatives of Bermuda inquired whether, following the entry into force of the Convention, the Secretary of the Treasury of the United States would be prepared to certify that assistance under the Convention, and subject to the understandings of this Note, would be satisfactory for purposes of section 927(e)(3) of the Internal Revenue Code of 1954, as amended (the "Code"), relating to countries qualifying as a jurisdiction in which a Foreign Sales Corporation (FSC) may be organized. The representatives of Bermuda also inquired whether the assistance provided for in the Convention, subject to the understandings of this Note, would be satisfactory for purposes of eligibility for convention tax benefits under section 274(h)(6) of the Code.

The representatives of the United States stated that upon entry into force of the Convention, and subject to the understandings contained in this Note, the Secretary of the Treasury, or his delegate, will be prepared to certify Bermuda for purposes of section 927(e)(3) of the Code such that a company organized under the laws of Bermuda may qualify as a FSC. Such certification would be published in the Federal Register and may be terminated effective six months after the date of publication of a notice of termination in the Federal Register. The United States Government also stated that, upon entry into force of the Convention, the Secretary of the Treasury, or his delegate, will be prepared to execute on behalf of the United States Government an executive agreement satisfying the requirements of section 274(h)(6) of the Code, which would incorporate by cross-reference the provisions of Articles 5 and 6 of the Convention and this Note, and would allow persons incurring expenses for attending business conventions in Bermuda to claim deductions for such expenses as though Bermuda were included as part of the "North American area."

(12) The representatives of Bermuda emphasized the necessity of including in the Convention additional provisions intended to prevent changes in US income tax treaty policy from adversely affecting the economic position of Bermuda's insurance and tourism industries relative to those of US treaty partners in similar circumstances under current US tax treaty policy. The United States representatives were not able to accept such provisions. However, the United States Government recognises that insurance and tourism

currently play a vital role in the Bermudian economy. If, in the future, the income tax treaty policies of the United States change in a manner which would have a material, adverse effect on such Bermudian business activities, compared with existing circumstances, the United States Government would be prepared to reopen the discussions in order to take account of such change in policies.

Her Britannic Majesty's Embassy have the honour to confirm to the Department of State that such understandings are acceptable to the Government of the United Kingdom of Great Britain and Northern Ireland on behalf of Bermuda.

The Embassy avail themselves of this opportunity to renew to the Department of State their assurances of their highest considerations.

EMBASSY OF THE UNITED KINGDOM
OF GREAT BRITAIN AND NORTHERN IRELAND,
11 July 1986.

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